

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Anderson Analyst: Jennifer Bettencourt Bill Number: AB 944
Related Bills: See Legislative History Telephone: 845-5163 Introduced Date: February 22, 2007
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exemption/First \$50,000 Of Qualified Income Of Qualified Member Of The California National Guard

SUMMARY

This bill would exempt from tax active duty pay received by qualified members of the California National Guard.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide a tax benefit that will be helpful for recruitment and retention for the California National Guard and provide some financial help for the Guardmember families.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

Summary of Suggested Amendments

Amendments 1 and 2 have been provided to resolve technical errors.

Board Position:

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<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Lynette Iwafuchi
for Selvi Stanislaus

5/2/07

ANALYSIS

FEDERAL/STATE LAW

Under federal and state laws, compensation received by a member of the armed forces is subject to income tax unless specifically excluded. Current federal law, which California conforms to, excludes the following from income tax:

- Living allowances
- Moving allowances
- Travel allowances
- Combat zone pay
- Family allowances
- Death allowances
- Other payments – Defense counseling, Group-term life insurance, disability etc.
- In-kind military benefits – dependent-care assistance program, legal assistance, medical/dental care, etc.

Members of the U.S. Armed Forces (including activated reservists, National Guard and Coast Guard members) who serve in a combat zone can also exclude military pay earned or paid during that time. The maximum exclusion of a commissioned officer is limited to the maximum amount excluded by an enlisted member. Income excluded from taxation is also exempt from withholding and not reported as taxable income by the military departments.

THIS BILL

This bill would exempt the first \$50,000 of qualified income of a qualified member from personal income tax.

This bill defines “qualified income” as federal or state active duty pay and “qualified member” as a member of the California National Guard who is either:

- Deployed overseas in a federal role, or
- Stationed 150 or more miles from his or her home in support of a federal or state mission for a period of more than 30 days.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

The first \$50,000 of active duty pay could include various types of compensation, some that are taxable and some that are exempt from tax under current law. As a result, it is unclear how to determine the first \$50,000 of active duty pay to be exempt from tax. The author may wish to amend the language to specify that the first \$50,000 does not include pay that is already excluded under state law.

This bill uses terms that are undefined, namely “Federal role,” “support of a federal or state mission,” and “home”. The absence of definitions to clarify these terms could lead to disputes with taxpayers and complicate the administration of this credit.

LEGISLATIVE HISTORY

SB 615 (Cedillo, Stats. 2004, Ch. 388) made California law compatible with the federal Servicemembers Civil Relief Act that was enacted on December 19, 2003.

AB 1766 (Maddox, 1999/2000) would have excluded from gross income any earnings received by an individual for active service as a member of the California National Guard. AB 1766 failed to pass out of the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois, Massachusetts, Michigan, Minnesota, and New York all conform to the federal law that excludes from tax income earned while serving in a combat zone.

Illinois excludes military pay for members of the U.S. Armed Forces Reserves and the *Illinois* National Guard without regard to active duty status.

Michigan and *New York* generally tax military pay for members of the National Guard and the U.S. Armed Forces Reserves that are domiciled and stationed in those states. Military pay from federal appropriations for active duty members is excluded from income.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 944 As Introduced 2/22/07 (\$ in Millions)		
2007-08	2008-09	2009-10
-\$1 million	< -\$500,000	< -\$500,000

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill. Taxable year estimates are converted to cash flow, fiscal year estimates, as shown in the table above.

Revenue Discussion

The revenue impact of the bill would be determined by the amount of qualified income of qualified members that is exempt from personal income tax under this provision that would otherwise be taxable, and the marginal tax rate of such taxpayers.

Active Duty Combat Zone Compensation

According to the California National Guard, approximately 1,800 qualified members are currently deployed overseas in a federal role, which includes both commissioned officers and enlisted personnel. Combat zone compensation of enlisted personnel is currently excluded from income, while a commissioned officer is taxable on the amount of the officer's pay that exceeds the maximum pay of an enlisted member, and would be exempt under this bill. This estimate assumes that 90 members (5% X 1,800) are commissioned officers with an average combat pay differential of \$1,400 per month. As a result, approximately \$1.5 million¹ of combat zone compensation would be exempt under this bill each year (90 X \$1,400 X 12 months).

Active Duty Non-Combat Zone Compensation

Currently, an additional 750 members are stationed 150 miles or more from home in support of a federal or state mission for a period of more than 30 days; this number normally averages around 300 members. According to the California National Guard, the current mission is set to end in early 2008. For the estimate, 750 members are used for 2007, decreasing to 40% of that, or 300 members, for 2008 and subsequent years. The following table includes the amount of active duty non-combat zone compensation that would be exempt from income tax under this bill:

Rank	Commissioned Officers	Warrant Officers	Other Enlisted Members	Total
Number of Qualified Members	38 (5%)	23 (3%)	690 (92%)	750 members
Annual Active Duty Non Combat Zone Compensation	\$60,000	\$43,200	\$30,000	-----
Less Proposed Exemption	-\$50,000	-\$50,000	-\$50,000	-----
Income Excluded Under this Provision (lesser of exemption amount or member's income)	\$50,000	\$43,200	\$30,000	-----
Total Exempt Income	\$1,900,000	\$1,150,000	\$20,700,000	\$23,750,000 ²

The total income for all National Guard members that would be exempt under this bill is rounded to \$25 million for 2007 (\$1.5 million¹ + \$23.7 million² = \$25 million). Applying a marginal tax rate of 4% results in a revenue loss of \$1 million (\$25 million x 4% tax rate = \$1 million). Beginning in 2008, the number of members stationed 150 miles or more from home for 30 days or more is reduced from 750 qualified members to 300, which reduces the exempt income from \$25 million to \$11 million for 2008 and subsequent years.

ARGUMENTS/POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill would provide a tax exemption for California National Guard members. Under existing law, the organized militia of California consists of the National Guard, the State Military Reserve, and the Naval Militia. Members of the National Guard are in most cases members of the Army or the Air Force Reserve. As a result, other members of the reserve components of the armed forces, i.e., the Navy, Marine Corps, and Coast Guard, and members of regular components of all branches would not be eligible for the exemption provided by this bill. Thus, this bill would provide differing treatment based solely on military affiliation.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 944
As Introduced February 22, 2007

AMENDMENT 1

On page 2, line 5, after (A) strikeout "Is"

AMENDMENT 2

On page 2, line 5, after (B) strikeout "Is"